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RUEHNE/AMEMBASSY NEW DELHI 2773  
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C O N F I D E N T I A L SECTION 01 OF 02 COLOMBO 000285

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SUBJECT: AMBASSADOR DISCUSSES IMF AGREEMENT AND CITIBANK  
WITH CENTRAL BANK GOVERNOR

REF: COLOMBO 244

Classified By: Ambassador Robert O. Blake, Jr. for reasons  
1.4 (b) and (d).

¶1. (SBU) SUMMARY: In a March 12 meeting with Ambassador, Central Bank Governor Cabraal disclosed that an IMF team is expected shortly in Colombo with a view to concluding an agreement in as little as one month. The Fund will be focused on GSL measures to help Sri Lanka strengthen and stabilize its reserves and reduce its budget deficit. Basil Rajapaksa, the President's brother and chief political advisor, will travel to Washington on March 19-20 to meet with Fund and World Bank officials. Cabraal and Trade Minister Peiris both reassured Ambassador that a letter from the Central Bank notifying Citibank Sri Lanka CEO Hussey that the bank is holding him personally accountable for the CitiBank hedging contracts with the Ceylon Petroleum Corporation did not reflect a change in the GSL's desire to negotiate amicably with Citi a restructuring of the hedging contracts. END SUMMARY

IMF Negotiations to Begin Shortly  
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¶2. (SBU) Ambassador opened by noting his surprise that the Central Bank Governor had gone public so soon (March 3) about the Government's intention to negotiate an agreement with the IMF. Cabraal responded that he had information that the Opposition UNP Party was about to leak the information with a highly unfavorable spin, so the President had authorized him to explain the Government's reasons for seeking IMF assistance. Cabraal said the decision had been correct, and opposition criticism thus far had been more muted than expected.

¶3. (SBU) Ambassador observed that the IMF apparently would be seeking to help Sri Lanka strengthen and stabilize its reserves and reduce its budget deficit. Cabraal agreed those would be key goals. With respect to the foreign exchange picture, Cabraal said current reserves are sufficient to cover six weeks of imports, but the Government needs cash flow. Hence it is negotiating currency swaps with Malaysia and perhaps other countries. Cabraal said Sri Lankan exports had declined by 10 percent in January 2009, but imports had dropped by 30 percent in value due to lower oil prices. Asked about remittances, a traditionally strong source of foreign exchange for the government, Cabraal did not think remittance revenues would drop substantially. He said that his counterparts from India, Pakistan, and Nepal had all told

him recently that they too were not experiencing significant drops in remittances. Moreover, more of Sri Lanka remittances were coming through the banking system than informal means such as hawalas. Asked about the Central Bank's efforts to raise foreign exchange through sovereign bonds, Cabraal said there had been a "good" response from the Sri Lankan Diaspora in Europe. He estimated that the Government had raised "tens of millions" of US dollars thus far towards its 2009 goal of 500 million dollars.

¶4. (SBU) Cabraal said the Government would address its fiscal deficit, both by raising revenues and cutting spending. He declined to specify what specific revenue measures Sri Lanka has in mind, noting only that new taxes on imports are under consideration, even though such taxes would adversely effect inflation, which recently had come down to 7 percent. He also predicted the Government would realize savings from declines in defense spending as the war in northern Sri Lanka winds down. Cabraal told Ambassador that he expects the IMF team to come back to Sri Lanka in the very near future with a view to negotiating an agreement in as little as one month's time.

#### Update on CitiBank Hedging Controversy

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¶5. (SBU) Prior to the meeting with the Governor, CitiBank Representative Dennis Hussey had informed the embassy that he had received a letter from the Central Bank notifying him that the bank is holding him personally accountable for the CitiBank hedging contracts with the Ceylon Petroleum

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Corporation that have been the subject of controversy after the GSL lost considerable foreign exchange with the fall in the price of the oil. Ambassador expressed surprise to the Central Bank Governor at the hostile tone of the letter, which appeared to be at variance with GSL efforts to find an amicable resolution to the controversy. The Ambassador asked the Governor if his letter signaled a change in the Government's attitude and noted the potential negative implications for Sri Lanka if a marquee investor such as CitiBank was forced to pull out of the country.

¶6. (SBU) Cabraal assured the Ambassador that there had been no change with the Government's desire to resolve the controversy amicably. He characterized the Central Bank letter as necessary to fulfill the Central Bank's regulatory responsibilities. He said the letter did not in any way preclude efforts by Trade Minister G.L. Peiris and Minister Amunagama to negotiate a restructuring of the hedging contracts.

¶7. (SBU) Ambassador subsequently spoke with Peiris to express concern about the Central Bank letter to CitiBank. Peiris responded that the Standard Chartered CEO in Sri Lanka had received a similar letter. Peiris (please protect) admitted he was "taken aback" by the Central Bank's letter because it was incompatible with the Government's policy to negotiate a solution with CitiBank. Peiris confided that he had taken a copy of the Standard Chartered letter to the President who had subsequently instructed Governor Cabraal to allow negotiations to proceed. Ambassador briefed Hussey on his conversations with Cabraal and Peiris. Hussey expressed relief about the President's continued support and thanked the embassy for its continued efforts.

#### Comment

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¶8. (C) Economic policy in Sri Lanka suffers from a lack of clear direction and leadership, as the machinations over the hedging contracts illustrate. Since the President has the Finance Minister portfolio and shows little interest in the details, the Treasury Secretary normally exercises great influence. However, since PB Jayasundera was eased out

because of an earlier controversy, the current Treasury Secretary does not wield the same influence. Jayasundera continues to play a very influential behind-the-scenes role as does Tourism Minister Moragoda who handled negotiations with the IMF under the previous UNP Government. Moragoda told Ambassador on March 12 that, given the leadership vacuum, he had urged Basil Rajapaksa, the President's brother and chief political advisor, to travel to Washington to meet with Fund and World Bank officials and then pass through Manila for talks with the ADB, and Japan for talks with Japanese finance officials. Rajapaksa called Ambassador on March 12 to inform us that he will visit Washington on March 19-20 to meet with Bank and Fund officials.

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